Talking Points: The Other Big Surprises

Big Food Blow-Ups and Little Food Blues

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Contents

In this edition we wrap up the main findings of our readership survey on the biggest surprises from 2019. Last month we covered the biggest surprise, what we dubbed the "Hype-P-O" of Beyond Meat, coupled with the broader surprise at the growth of the plant-based sector. It was a surprise to many that our local fast food joint would be the growth vector for this trend. And on this divisive subject, not everyone was a believer, with many expressing surprise at how people have got caught up this 'shiny new thing' and not for a moment think it might, like many past fads, crash and burn. As one put it, "how did the 20-year trend around increased transparency and simplicity in food ingredients evaporate with the advent of fake meat?" In this edition, we prune back all those plant-based discussions to shed some light on other areas that, as far as our readers were concerned, surprised them in 2019. Here are five themes:

1. **Big food blow-ups... – Kraft Heinz's "meltdown"**. It was a year ago but our readers haven't forgotten.

2. **... and little food blues** – The grass was not necessarily greener in start-up land either. For the first time we heard growing discontentment and disillusionment with emerging brands.

3. **Purpose & responsibility** – It seems that being a purpose-driven company is no longer just the remit of emerging brands. Although the concept of valuing all stakeholders and not just shareholders is not new, 2019 seems to have been a landmark year.

4. **"The CBD gold rush"** – Two years ago, a reader wrote about the CBD market as "sure feels like the Wild West." In this survey it seems like our readership feels we are still stuck in Dodge City.

5. **A six-surprise finale** – We got a lot of comments on a diverse range of subjects that don't always fit neatly into bigger buckets.

1) Big Food Blow-ups...

The goings on at Big Food always elicit responses from our readership. This time around, many readers called out last February's "great Kraft-Heinz meltdown" as one of the biggest surprises. A year ago, the company was forced to issue a "huge profit warning" and among, other things, a USD 15bn write off for its Kraft & Oscar Meyer brands. In the opinion of one reader, this led to the market "quickly and severely punishing KHC for missing their numbers due to a lack of innovation." It is worth recalling that two years ago, when all eyes were focused on margin expansion, around the time the company was trying to buy Unilever, Kraft-Heinz had a market capitalization of USD 117bn. Today, it is around USD 36bn, having lost about USD 23 in market capitalization over the last twelve months.

Twelve months on from KHC's existential crisis, readers were still out with their knives. Some readers described this as an implosion but most as a "blow-up" recognizing that there were wider ramifications for the industry, not least the future relevance of its "zero-based budgeting business model." The lesson from Kraft-Heinz, one felt, firmly debunked the idea that "radical cost-cutting works in food". Similarly, another felt the Kraft-Heinz experience had discredited "the zero-based budgeting model and cost-cutting as a means to prosper in the food and beverage industry." "Yes," one wrote, "we always thought they were cutting away more than fat with their rigorous ZBB, but that they were destroying so much value was a surprise."

One reader felt the model still lived on and that some companies are still "stuck like deer in headlights trying to replicate 3G/KHC after that model has failed. But others were more sympathetic to the 3G model (which was more than just zero-based budgeting), where companies had found margin relief as "cost synergies from deals more than offset continued sluggishness on the top line." But others felt this debunking seemed to give some companies permission to invest. Now that companies are pushing back, or at least de-emphasizing cost-cutting, this has allowed greater emphasis on R&D (aka innovation) as well as marketing and their supply chains.

One reader noted the increasing dispersion in performance between big food companies in the US where some big food companies have, "figured out how to stop haemorrhaging share and compete effectively." In a similar vein, one Big Food optimist expressed muted surprise by the "turnaround or traction at companies like Campbell's and ConAgra" when it could have been "game over." In other words, they are still around when he was expecting them to no longer be around.

There were also some readers who expressed surprise that there were "no big moves in Big Food." 2018 was the year of the "mega deal" such as Campbell's Soup and Snyder's Lance; ConAgra and Pinnacle but "2019 felt quiet." If large food companies really are trying to be transformational, "I would have expected more movement" and not necessarily deals but partnerships and alliances. The conclusion for one was "Makes me think that nothing has really changed at all. It is still transactional," presumably meaning that companies were simply trying to find the missing pieces through M&A.

2) ... and Little Food Blues.

The grass was not necessarily greener in start-up land either. For the first time we heard growing discontentment and disillusionment with emerging brands. Four related themes emerged:

Despite slowdowns, valuations remain high. One investor was puzzled that the slowdown in acquisitions of 'better for you' food companies by large food companies, "hasn't really impacted the valuations of privately-funded rounds from seed to later-stage funding." Readers shared anecdotes of a lot of founders who are still pointing to three year old comps and expecting similar valuations. Another thought we were on the cusp of this change, commenting, "I saw my first down round of an early-stage food company. It was significant and totally wiped out the founders/early investors. I think we will see a lot of this going forward and I'm surprised it hasn't happened already."

Fewer 100% acquisitions. Tied to this has been the apparent shift away from total acquisitions and instead "we are looking at a majority ownership from a strategic and a minority stake from a PE group." Examples of this include Mondelēz acquiring a majority stake in Perfect Bar in July 2019 and Vestar Capital making a minority investment in Simple Mills in October 2019.

Growing pains. One reader had started to notice a lot of companies "getting stuck". In her words, "they reach a certain size, but aren't growing fast enough to justify steps up in valuation, still not to the point of being profitable, so it becomes hard to build the story to raise money." The fact that many start-ups are struggling to turn a profit and maintain the pace of growth has led to investors becoming more careful with respect to various sectors such as ecommerce and certain CPG categories. A consequence of this is that venture capital firms are now looking to 'roll up' opportunities for brands "that aren't ready for prime time." For example, private equity firm VMG Partners has set up an incubator-like entity called VMG Velocity Snack Brands to nurture these smaller brands (as well as build brands of its own).

Introducing the copycat snack bar. Perhaps one reason companies fail to scale is the speed at which CPG challenger brands copy each other? As one put it, "you find a new differentiated one, and three months later there are at least a handful of other identical brands. They end up eating each other's lunch and it makes it almost impossible to pick a winner." There seem to be plenty of categories where there is happening, "soy-based chicken chunks, popped lotus seeds, hard seltzers and, in Europe, meal replacement drinks (every country has their own now)." One gloomily forecast, "the sheer number of products being introduced into the market, the narrowness of the niches being pursued and the lack of available shelf space at retail (e.g. slotting fees required) makes the long-term success of the vast majority of these introductions highly questionable."

3) Purpose & Responsibility

It seems that being a purpose-driven company is also no longer just the remit of emerging brands. We got several variations on, "the big surprise to me in 2019 was how 'purpose' as a term, but also the actions that big food companies are undertaking, really came to forefront." Yet the concept of valuing all stakeholders and not just shareholders is not new, after all, the concept of a triple bottom line (social, environmental and financial) was first espoused over 25 years ago. But 2019 seems to have been a landmark year.

For example, last year, putting shareholder value creation not as the key goal, but as a goal among many, was widely subscribed to by over 180 CEOs of leading US companies who form the Business Roundtable. In August 2019, the roundtable redefined the purpose of a corporation is to benefit all stakeholders – customers, employees, suppliers, communities and shareholders. One reader commented that many European companies, both public and private "were already shifting to be purpose-led such as Unilever, Danone and Barilla." Another expressed surprise that it was a private-equity-owned company, Wessanen, that "has become Europe's first multinational B-Corp food company." Others speculated that the "statement by the Business Roundtable will be viewed as a milestone when people look back in history 10 to 20 years from now." There is an alphabet soup of acronyms describing the slew of other initiatives around responsible investing, such as the soon to be mandatory reporting on climate-related financial disclosures (TCFD) by 2,500 signatories (with a combined total assets under management of USD 90 trillion) to the United Nation's Principles of Responsible Investing (PRI). And another was Science-Based Targets Network (SBTN), where "more than 40 food companies have committed to SBTs to purchase carbon onsets" (according to the SBTN, over 770 companies are already using science to specify how much and how quickly they need to reduce their greenhouse gas emissions as a way of future-proofing growth and reducing risk). Another expressed surprise at the number of animal protein producers that are reducing carbon emissions with a net zero carbon emissions goal by 2030 – "Some are already half way there. The dairy sector may be the furthest on this journey."

Readers felt this movement was being driven by "the rise of sustainability and related topics to the top of the (consumer) agenda" both here and around the world. One wrote, "I have been amazed by the speed and intensity at which consumers are now asking and holding accountable companies to be the leading force for change on crucial societal issues." Another felt the pace at which sustainability and environmental impact has become a priority project for the food industry was the result of a "sudden convergence of parallel discussions around impact from traditional cattle/meat, plastic pollution and the glyphosate ban, the latest UN predictions on climate risks, and, of course, Greta."

Survey respondents also honed in on the public's concern over plastics. Respondents were surprised at "the rapid escalation of plastic packaging as an issue in the public consciousness" which has left "Big Food companies all scrambling to respond to the plastic issue." Readers felt this reflected concern for the environment not only from the millennials "but all generations of consumers." In turn, this led to a belief that "how companies react will shape the success of their brands" as well as sense of excitement and optimism around "how to increase bio-diversity in food products with a positive impact on the planet."

4) "The CBD Gold Rush"

In our last survey, the "explosion of interest" in CBD (cannabidiol – a non-psychoactive compound found in hemp and marijuana – both members of the cannabis genus) and the lack of regulation and oversight led readers to conclude, "sure feels like the Wild West." Twelve months on, it seems like our readership feels we are still stuck in Dodge City. "The CBD gold rush boggles the mind," one reader noted. Another reflected on the "crazy, uncontrollable, unregulated rise of CBD everywhere". Certainly, to many old-hands the widespread adoption of an unapproved unlawful food additive felt unprecedented (in November 2019, the FDA stated again that CBD cannot be considered GRAS – Generally Recognized As Safe because of the "lack of scientific information supporting the safety of CBD in food").

Respondents were simply incredulous about the "meteoric rise of CBD everywhere, despite real questions about efficacy, regulation and quality." "What was the consumer thinking?" one asked. "I would not have thought," wrote another, "that consumer demand for a poorly understood substance would support things like CBD sparkling water, protein powder, CBD everything… but here we are!" And let's not forget about its growing applications for pets too. Others felt consumers, with their growing disdain for "experts", had been seduced by the snake oil of quacks on social media - "We have really extended disbelief and they are willing to put anything on the market without safety studies as long as social media promises living forever." In reading these comments, my colleague Jim Watson, weighed in with, "the consumer belief in the health and wellness properties of CBD is highly correlated to views of the medical benefits of marijuana. Which is to say – yes CBD is very poorly understood, but consumers don't look at it as a standalone."

And like the "glaringly inconsistent" criticism of consumer demand for highly-processed meat substitutes, readers called out those consumers and organizations who, "complain" about perceived safety issues associated with food additives, despite years of research and volumes of data attesting to their safety, yet when it comes to CBD and related cannabinoids, "consumers readily accept their inclusion in foods and medications in the virtual absence of safety data and in the face of a spectrum of adverse effects." Investors as well as food and dietary supplement companies too, were willing to "plunge in" possibly because of the fear of missing out in a market that is reportedly growing triple digits over 2018. "The promise of fast-emerging consumer demand empowers companies to ignore the push back" In beverages at least, only rather small players have entered the CBD market – and global players are approaching with great caution (Heineken is one of the very few – the company's Lagunitas operation sells infused beverages through California and Colorado). So there is a gold rush only among those with little to lose.

Besides panning the impact of social media on city-slickers, in promising CBD as a cure-all-tonic for everything from anxiety, arthritis, and even anger, readers also laid the blame at the door of the Sheriff, the FDA, for their "low key approach to communications and enforcement." Others saw it as a capitulation - "a complete and utter surrender on CBD." Despite CBD not being approved by the FDA for use in food and beverages, their early silence and "lack of action related to its regulatory status has now created this mess." Readers felt that it was the FDA's failure to not "issue a stronger, clearer statement about the legal status of CBD in foods and dietary supplements after the 2018 Farm Bill passed" that effectively gave the industry "a green light to use CBD."

One industry veteran was bemused to report that "when my friends ask my opinion of CBD, I tell them it's not allowed in food. Then they want to know why so many food and beverage products are available? It's crazy." "Maybe" one suggested it is because we are "ten years into a bull market and the sense that anything cannabis related is headed for full legality?"

5) A Six-Surprise Finale

We got a lot of comments on a diverse range of subjects that don't always fit neatly into bigger buckets. For our finale, let's close with six stand-out standalone observations:

I. "I was most surprised by the continued growth of indulgent categories. Despite all the talk of health and wellness, and headlines around more nutritious diets, the fact is that people like a treat."

II. "The explosion of interest in regenerative agriculture. In my opinion, organic isn't enough for the modern consumer, and regenerative will take market share."

III. "The fact that cereal is the hottest DTC consumable product! If you would have told me that a year ago, I would have laughed in your face!"

IV. "Despite a generally favorable economy, traffic continues to decline in restaurants and no one fully understands why (retail sure isn't picking up the volume)."

V. "The avalanche of scientific studies demonstrating the negative effects on health from consuming ultra-processed foods that are distinguished from other processed foods by having no resemblance to the foods from which they were derived, requiring industrial production, containing ingredients not found in home kitchens."

VI. "I'm surprised by the frequency of, and different types of, collaboration occurring in the food industry. From coordinating sourcing across brands, to increased buying power and the market for regenerative ingredients, to sharing sustainable packaging resources and solutions, industry leaders are helping each other to be better, more profitable, and to have a more positive impact on the world."

Imprint

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